

# Inspector General

United States  
Department of Defense



Internal Controls Over the Department of the  
Navy Military Equipment Baseline Valuation Effort

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## Acronyms and Abbreviations

AV	Acquisition Value
NBV	Net Book Value
P&EPO	Property and Equipment Policy Office
SFFAS	Statement of Federal Financial Accounting Standards



INSPECTOR GENERAL  
DEPARTMENT OF DEFENSE  
400 ARMY NAVY DRIVE  
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October 31, 2008

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE FOR ACQUISITION,  
TECHNOLOGY, AND LOGISTICS  
UNDER SECRETARY OF DEFENSE  
(COMPTROLLER)/CHIEF FINANCIAL OFFICER  
NAVAL INSPECTOR GENERAL

SUBJECT: Internal Controls Over the Department of the Navy Military Equipment Baseline  
Valuation Effort (Report No. D-2009-008)

We are providing this report for your information and use. We performed this audit in response to a request from the Property and Equipment Policy Office in the Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics. We considered comments from the Under Secretary of Defense for Acquisition, Technology, and Logistics and the Department of Navy when preparing the final report.

Comments on the draft of this report conformed to the requirements of DoD Directive 7650.3 and left no unresolved issues. Therefore, we do not require any additional comments.

We appreciate the courtesies extended to the staff. Please direct questions to Mr. Edward A. Blair (216) 706-0074 extension 226 or Mr. Gregory M. Mennetti at (216) 706-0074 extension 267. The team members are listed inside the back cover.

*Patricia A. Marsh*  
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Assistant Inspector General  
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October 31, 2008



# Results in Brief: Internal Controls Over the Department of the Navy Military Equipment Baseline Valuation Effort

## What We Did

We assessed the effectiveness of the Department of the Navy's (Navy) internal controls over the valuation, rights and obligations, and completeness of military equipment programs to determine whether the Navy's military equipment baseline was adequate. This report is one in a series.



Aircraft assigned to Carrier Air Wing (CVW) 5 fly over the aircraft carrier *USS Kitty Hawk* (CV 63).

Photo Courtesy of Mass Communication Specialist 3rd Class Kyle D. Gahlau

## What We Found

The Navy and the Property and Equipment Policy Office did not have adequate internal controls in place over the Navy military equipment baseline. As a result, management:

- did not properly classify assets, use the asset's correct useful life, and value accurate program acquisition values (Valuation);
- improperly classified assets and used the asset's incorrect placed-in-service date (Rights and Obligations); and
- improperly included assets as military equipment and granted waivers (Completeness).

## What We Recommend

We recommend that the Under Secretary of the Navy:

- implement and follow procedures for classifying assets as military equipment, establishing each asset's useful life, determining each asset's placed-in-service date, and obtaining and maintaining supporting documentation to comply with Federal and DoD guidance;
- maintain documentation to support improvements and estimated useful life; and
- verify the reliability and accuracy of source records and the completeness of the military equipment program universe.

## Client Comments and Our Response

The Under Secretary of the Navy agreed with the recommendations, and his comments meet the intent of the recommendations. Please see the recommendations table on the back of this page.



Aircraft assigned to Carrier Air Wing (CVW) 14 are stacked on the bow of *USS Ronald Reagan* (CVN 76).

Photo Courtesy of Mass Communication Specialist 3rd Class Gary Prill

## Recommendations Table

Client	Recommendations Requiring Comment	No Additional Comments Required
Under Secretary of the Navy	None	1., 2., 3., 4., 5., 6.

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# Introduction

## Objectives

Our objective was to determine whether the internal controls over the Department of the Navy's military equipment baseline were adequate. Specifically, we assessed the effectiveness of the Department of the Navy's internal controls over the valuation, rights and obligations, and completeness of military equipment programs. See Appendix A for a discussion of the scope and methodology, a review of internal controls, and for prior coverage related to the objectives.

## Background

The Property and Equipment Policy Office (P&EPO) in the Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics requested that the DoD Office of Inspector General perform procedures to review the military equipment baseline as of September 30, 2006. Officials in the P&EPO and the Office of Inspector General discussed and agreed upon objectives for the audit. The agreed-upon objectives included evaluating the reliability of the internal controls over the military equipment programs for the financial statement assertions: valuation, rights and obligations, and completeness.

The Under Secretary of Defense for Acquisition, Technology, and Logistics and the Under Secretary of Defense (Comptroller)/Chief Financial Officer established the P&EPO in December 2000 to ensure a consistent military equipment valuation methodology. The P&EPO led the Department-wide effort to achieve compliance with the Statement of Federal Financial Accounting Standards (SFFAS) No. 23, "Eliminating the Category National Defense Property, Plant, and Equipment," May 2003, by developing the military equipment program universe and performing the initial military equipment valuation. The P&EPO developed the universe to identify all military equipment programs. The P&EPO used budget reports and asset data obtained from DoD accountability and logistics systems to develop the military equipment program universe. The initial military equipment valuation developed a value for the military equipment programs for inclusion in the DoD financial statements. The process was a manual effort that began in FY 2002 and continued through FY 2006 with the implementation of Capital Asset Management System–Military Equipment. The Capital Asset Management System–Military Equipment captures asset status and expenditures. In addition, it values, capitalizes, and depreciates delivered assets, and it reports financial and management data.

Military equipment valuation is a DoD-wide effort to implement Federal accounting standards requiring military equipment to be capitalized and recorded on the DoD financial statements. Previously, DoD classified military equipment as National Defense Property, Plant, and Equipment, which was expensed in the year it was acquired. In May 2003, the Federal Accounting Standards Advisory Board issued SFFAS No. 23, which eliminated the category of National Defense Property, Plant, and Equipment and reclassified military equipment to General Property, Plant, and Equipment. SFFAS

No. 23 requires that the initial capitalization amount for assets previously considered National Defense Property, Plant, and Equipment be based on historical cost in accordance with the asset recognition provisions of SFFAS No. 6, "Accounting for Property, Plant, and Equipment," as amended, and should be the initial historical cost for the items, including any major improvements or modifications.

SFFAS No. 6, defines Property, Plant, and Equipment as tangible assets that have an estimated useful life of 2 or more years, are not intended for sale in the ordinary course of business, and are intended to be used or available for use by the entity. SFFAS No. 6 states that depreciation expense is calculated through the systematic and rational allocation of the cost of General Property, Plant, and Equipment, less its estimated salvage or residual value, over the estimated useful life of the General Property, Plant, and Equipment. The Standard requires costs that extend the useful life of existing General Property, Plant, and Equipment or increase or improve its capacity to be capitalized and depreciated and/or amortized over the remaining useful life of the associated General Property, Plant, and Equipment.

DoD Regulation 7000.14-R, the "DoD Financial Management Regulation," volume 4, chapter 6, Property, Plant, and Equipment, July 2006, defines General Property, Plant, and Equipment as tangible assets that meet all of the following criteria:

- have an estimated useful life of 2 years or more;
- are not intended for sale in the ordinary course of operations;
- are acquired or constructed with the intention of being used or available for use by the entity; and
- have an initial acquisition cost, book value, or; when applicable; an estimated fair market value that equals or exceeds the DoD capitalization threshold, which is \$100,000.

This includes assets that had previously been classified as National Defense Property, Plant, and Equipment; bulk purchases; and assets used in providing goods or services. It also includes assets that support the mission of the entity. Additionally, the costs to improve General Property, Plant, and Equipment should be capitalized when the improvement increases the asset's capability, size, efficiency, and useful life, or modifies functionality and would not otherwise be considered maintenance or repairs.

All General Property, Plant, and Equipment assets acquired by DoD must be recognized for accountability and financial reporting purposes. Recognition requires the proper accounting treatment (expense or capitalization and depreciation or amortization) and the reporting of capitalized amounts and accumulated depreciation or amortization on the appropriate DoD Component's financial statements. The DoD Component that procures a General Property, Plant, and Equipment asset or the DoD Component in possession of a

General Property, Plant, and Equipment asset will be the DoD Component that accounts for and reports the asset.<sup>1</sup>

### ***Management Assertions***

Management assertions are representations by management about information in the financial statements. The primary management assertions for the Military Equipment line item are listed in Table 1.

<b>Table 1. Management Assertions</b>	
<u>Assertion</u>	<u>Management Representation</u>
Valuation or Allocation	All military equipment is properly valued.
Rights and Obligations	The Navy owns all military equipment reported in the financial statements.
Completeness	All military equipment owned by the Navy is reported in the financial statements.
Existence or Occurrence	All military equipment assets reported in the financial statements existed at the time.
Presentation and Disclosure	All military equipment assets are correctly reported in the financial statements.

Our audit focused on the assertions for valuation, rights and obligations, and completeness applicable to the Navy military equipment baseline.

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<sup>1</sup> The DoD Regulation 7000.14R also refers to this principle as the preponderance of use.



# Valuation of the Department of the Navy Military Equipment Baseline

The internal controls over the Navy military equipment baseline were inadequate. Specifically, the Navy and Property and Equipment Policy Office (P&EPO) did not establish adequate internal controls over the financial statement assertions of valuation (classification, estimated useful life, and acquisition values); rights and obligations (classification and placed-in-service dates); and completeness (number of assets and waivers). As a result, we identified a \$16.7 billion Net Book Value (NBV) misstatement and a \$1.8 billion Acquisition Value (AV) misstatement<sup>2</sup> in the military equipment baseline. See Appendix B, Figure K for details. Additionally, the lack of support for the classification of modifications, estimated useful lives, and military equipment baseline waivers and incorrectly providing waivers could materially increase the misstatement of the military equipment valuation baseline. To improve controls, the Navy and the P&EPO should follow established guidance, establish and maintain support for military equipment data, and verify the reliability of source records and completeness of the military equipment program universe.

## Military Equipment Baseline

To test the financial statement assertions of valuation and rights and obligations, we judgmentally selected 35 programs from the Navy military equipment baseline universe. For those 35 military equipment programs, we reviewed assets valued at \$95.6 billion AV with a corresponding \$54.1 billion established NBV. See Appendix B, Figure A for details. To test the financial statement assertion of completeness, we examined documentation for all ships, aircrafts, and 13 other asset programs from the Navy military equipment program universe.<sup>3</sup>

## Valuation Assertion

The Navy and the P&EPO did not establish adequate internal controls over valuation. Specifically management did not:

- properly classify assets,
- use the assets correct useful life, and
- calculate accurate program acquisition values.

The Navy and the P&EPO did not establish adequate internal controls over valuation because management did not follow established guidance, provide documentation to fully support the assets classification, and verify the reliability of source records.

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<sup>2</sup> \$16.7 billion NBV and \$1.8 billion AV reflect the net misstatement value on the financial statements. The total value of misstatements was \$18.6 billion NBV and \$1.8 billion AV.

<sup>3</sup> The Navy military equipment program universe includes all programs regardless of value as of September 30, 2006. The Navy military equipment baseline universe includes only programs with a value greater than zero as of September 30, 2006.

## **Classification**

The Navy and the P&EPO did not properly classify assets and improvements as military equipment. The Navy and the P&EPO improperly classified five programs, valued at approximately \$2.9 billion AV, as military equipment that were not available for military missions, did not meet the capitalization threshold, or were not improvements. See Appendix B, Figure B for details. The Navy and the P&EPO did not properly classify these assets because they did not follow the DoD Regulation 7000.14-R, volume 4, chapter 6, “Property, Plant, and Equipment,” July 2006. As a result, we identified a misstatement of \$1.3 billion NBV in the military equipment baseline. The Navy and the P&EPO should follow DoD guidance when classifying assets as military equipment.

In addition, we were unable to determine whether management properly classified improvements (modifications) for 10 programs, valued at \$10.6 billion AV (\$5.8 billion NBV). See Appendix B, Figure C for details. We were unable to determine whether management properly classified these assets because available documentation did not fully support classifying the asset as an improvement, as defined by SFFAS No. 6, and DoD Regulation 7000.14-R, volume 4, chapter 6. For example, the purpose of the Nuclear Refueling Complex Overhaul for the USS *Dwight D. Eisenhower* (CVN-69) was to refuel the reactors, and repair and upgrade the main propulsion equipment. Generally, the cost of fueling a ship and its repair is an expense, but the upgrade (if the asset is not failing) is a capital improvement. We were unable to determine from the supporting documentation provided whether the Nuclear Refueling Complex Overhaul was an improvement because the Navy did not specifically support the modifications as upgrades. As a result, we identified a possible misstatement in the military equipment baseline. The Navy and the P&EPO should follow existing guidance to assist in classifying assets as military equipment and establish documentation to support improvements that are classified as military equipment.

## **Estimated Useful Life**

The Navy and the P&EPO did not use the correct estimated useful life for military equipment assets. The Navy and the P&EPO used values different from those provided by the program offices for nine programs, valued at approximately \$16.5 billion AV. See Appendix B, Figure D for details. In addition, we could not determine whether management established the appropriate estimated useful life for six programs, valued at approximately \$5.5 billion AV (\$2.3 billion NBV). See Appendix B, Figure E for details. The Navy and the P&EPO did not use and establish correct useful lives because management did not follow the DoD Regulation 7000.14-R, volume 4, chapter 6, and volume 1, chapter 3, “Accounting Systems Conformance, Evaluation, and Reporting,” May 1993, that requires financial transactions to be adequately supported with pertinent documents and source records. As a result, we identified a misstatement of \$947.6 million NBV and a potential misstatement in the military equipment baseline. The Navy and the P&EPO should follow Federal and DoD guidance when determining the assets’ estimated useful life and establish documentation supporting the estimated useful life.

## **Acquisition Values**

The Navy and the P&EPO did not calculate accurate program acquisition values. For 11 of the programs, valued at approximately \$57.2 billion AV, the program acquisition totals were inaccurate. See Appendix B, Figure F for details. The Navy and the P&EPO did not calculate accurate program acquisition values because the Navy did not verify the reliability of source records. We found that disbursement totals were greater than expenditure totals used to value the programs. For example, the USS *Ronald Reagan* (CVN 76) was valued at \$4.5 billion AV using expenditure data and \$4.6 billion AV using disbursement data. As a result, we identified a misstatement of \$1.8 billion AV in the military equipment baseline. The Navy in conjunction with the Defense Finance and Accounting Service should verify the reliability and accuracy of the source records.

## **Rights and Obligations Assertion**

The Navy and the P&EPO did not establish adequate internal controls over rights and obligations. Specifically, management did not properly classify assets and use the assets' correct placed-in-service date. The Navy and the P&EPO did not establish adequate internal controls over rights and obligations because management did not follow established guidance.

## **Classification**

The Navy and the P&EPO improperly classified other DoD Components' assets as Navy military equipment. The Navy incorrectly recorded Marine Corps assets as Navy military equipment for aircraft valued at approximately \$26.8 billion AV. See Appendix B, Figure G for details. The Navy and the P&EPO did not properly classify Marine Corps assets because they did not follow DoD Regulation 7000.14-R, volume 4, chapter 6, "Preponderance of Use Guidance." These assets are owned and used by the Marine Corps and should be included in the Marine Corps financial statements. As a result, we identified a misstatement of \$12.8 billion NBV in the Navy military equipment baseline. The Navy and the P&EPO should follow DoD guidance when classifying military equipment assets.

## **Placed-in-Service Date**

The Navy and the P&EPO did not use the correct placed-in-service date for military equipment assets. The Navy used incorrect placed-in-service dates for four programs, valued at \$16.9 billion AV. See Appendix B, Figure H for details. For example, the Nuclear Refueling Complex Overhaul for the USS *Carl Vinson* (CVN 70) was placed-in-service prior to FY 2006. However, scheduled completion of the Nuclear Refueling Complex Overhaul for the USS *Carl Vinson* (CVN 70) is March 2009. In March 2009, the Navy should place this portion of the asset in service. The Navy and the P&EPO did not use the correct place-in-service date because management did not follow DoD Regulation 7000.14-R, volume 4, chapter 6. As a result, we identified a misstatement of \$722.6 million NBV in the military equipment baseline. The Navy and the P&EPO should follow DoD guidance to record accurate placed-in-service dates.



## **Completeness Assertion**

The Navy and the P&EPO did not have effective internal controls over completeness. Specifically, management did not record the correct number of assets as military equipment and inappropriately granted waivers allowing exclusion of military equipment programs from the baseline. The Navy and the P&EPO also did not verify the completeness of the military equipment program universe, follow established guidance, and provide sufficient supporting documentation.

### ***Number of Assets***

The Navy and the P&EPO did not record the correct number of ships and aircraft as military equipment. The Navy and the P&EPO incorrectly classified 10 ships, valued at approximately \$1.2 billion AV, as military equipment and excluded 14 ships that were military equipment. See Appendix B, Figure I for details. In addition, management incorrectly classified 167 aircraft, valued at approximately \$4.1 billion AV, as military equipment and excluded 28 aircraft that were military equipment. See Appendix B, Figure J for details. The Naval Vessel Register and the Aircraft Inventory and Readiness Reporting System identified specific assets as part of the active battle inventory, which differed from those provided by the Navy and the P&EPO. The Navy and the P&EPO did not record the correct number of ships and aircraft because management did not verify the completeness of the program universe. As a result, we identified a misstatement of \$2.8 billion NBV and an omission of assets in the military equipment baseline. The Navy and the P&EPO should verify the completeness of the ship and aircraft universe.

### ***Waivers***

The Navy and the P&EPO did not effectively control the waiver process. The P&EPO improperly granted waivers to three programs that should have been included in the military equipment baseline. For example, the LCC-19 Blue Ridge Class Program was fully depreciated and granted a waiver based on a useful life of 25 years. However, we determined that the useful life is 40 years and as of September 30, 2006, should have had 5 years of remaining depreciable value and useful life. The Navy and the P&EPO did not properly grant waivers because they did not consistently follow DoD Regulation 7000.14-R, volume 4, chapter 6 on useful life and preponderance of use. As a result, management omitted transactions, causing an understatement of the Military Equipment line item. The P&EPO should consistently follow DoD Regulation 7000.14-R guidance when assigning useful life and preponderance use to military equipment.

In addition, we could not determine whether the P&EPO properly granted waivers to 45 programs and whether they assigned 66 programs the correct waiver category. We could not determine whether waivers were properly granted or given the proper category because the Navy and the P&EPO did not provide sufficient supporting documentation. As a result, this could cause an understatement of the financial statements. The Navy and the P&EPO should include documentation in each waiver to support the reason for and category of the waiver.

## **Client Comments on the Finding and Our Response**

Although not required to comment, the Director, Acquisition Resources and Analysis, Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics provided the following comments on the finding. For the full text of Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics comments, see Client Comments.

***Under Secretary of Defense for Acquisition, Technology, and Logistics Comments.*** The Director stated that the final report should clarify whether the identified assets misstated for the valuation, rights and obligations, and completeness assertions could be reported as General Property, Plant, and Equipment instead of Military Equipment. In addition, the final report should indicate whether the DoD Office of Inspector General supports capitalization using the Group and Composite methodology to capitalize all items in a group as long as a single item from the group exceeds the capitalization threshold of \$100,000.

The Director stated that the final report should identify that the responsible program managers provided and attested to the data and information included in the valuations. In addition, the Director stated that the report should recognize that valuations were based on the expenditure data from Navy accounting systems.

The Director stated that the draft report indicated that a number of assets were misclassified as Military Equipment and that the audit results relied on information included in the Naval Vessel Register and the Aircraft Inventory and Readiness Reporting System to make these determinations. Because the accounting standards do not define Military Equipment, the criteria used to categorize assets as Military Equipment should be based on the definition developed by DoD, not by the system used to track the assets.

***Our Response.*** The objective of this audit was to determine whether the internal controls over the valuation of the Department of the Navy's military equipment baseline were adequate. Specifically, we assessed the effectiveness of the Department of the Navy's internal controls over the valuation, rights and obligations, and completeness of military equipment. The scope of our testing was limited to reviewing programs to determine whether adequate controls were in place to support the initial baseline valuation effort. We did not design our testing to identify the proper accounting treatment for programs not accurately classified as military equipment. We performed and gathered testing support for the \$16.9 billion NBV misstatement identified for Valuation Testing – Classification, Rights and Obligations Testing – Classification, and Completeness Testing – Number of Assets. We determined that the Navy would not reclassify \$15.2 billion NBV of the misstatement as General Property, Plant, and Equipment. The remaining \$1.7 billion NBV of the misstatement would require additional testing to determine the proper accounting treatment. In addition, a summary report on the military equipment baseline valuation will address the DoD Office of Inspector General stance on capitalizing all items in a group as long as a single item exceeds the capitalization threshold of \$100,000.

The Military Departments maintain the overall responsibility for the accuracy of their financial statement, and we recognized that by addressing all recommendations to the Department of the Navy. However, the P&EPO had primary responsibility for developing the universe and initial valuation process. Therefore, the P&EPO needs to support and provide guidance to the Military Departments to establish an accurate reliable baseline.

The information available in the Naval Vessel Register and the Aircraft Inventory Readiness Reporting System represent the official inventory of the Navy's ships and aircraft from the time of authorization through their life cycles and disposals. The DoD definition of military equipment states that military equipment are weapon systems that can be used directly by the Armed Forces to carry out battlefield missions. Both of these systems report the status of the assets (that is, the availability for military missions). The value of Military Equipment should exclude Navy assets not available for military missions.

## **Recommendations, Client Comments, and Our Response**

**We recommend that the Under Secretary of the Navy:**

**1. Implement and follow procedures for classifying assets as military equipment, establishing assets useful life, and determining assets' placed-in-service date to comply with DoD Financial Management Regulation volume 4, chapter 6, "Property, Plant, and Equipment," July 2006.**

***Navy Comments.*** The Deputy Assistant Secretary, Office of the Assistant Secretary (Financial Management and Comptroller) concurred. The Deputy Assistant Secretary, Office of the Assistant Secretary (Financial Management and Comptroller) will publish clear guidance for Navy field activities. This guidance will include applicable existing DoD regulations and address the Navy's approach and expectations for classification and determination of placed-in-service dates and estimated useful life for military equipment. The Navy will publish the guidance no later than September 30, 2009.

***Our Response.*** The Deputy Assistant Secretary, Office of the Assistant Secretary (Financial Management and Comptroller) comments are responsive to the intent of the recommendation.

**2. Implement and follow procedures for classifying assets as military equipment and establishing assets' useful life to comply with the Statement for Federal Accounting Standards No. 6, "Accounting for Property, Plant, and Equipment," June 1996 as amended.**

***Navy Comments.*** The Deputy Assistant Secretary, Office of the Assistant Secretary (Financial Management and Comptroller) concurred. The Deputy Assistant Secretary, Office of the Assistant Secretary (Financial Management and Comptroller)

will publish clear guidance and develop and test internal controls for Navy field activities. Publishing guidance and developing internal controls will ensure that classification and determination of placed-in-service dates and useful life for military equipment will reflect the requirements of SFFAS No. 6. The Navy will publish guidance and develop controls no later than September 30, 2009.

***Our Response.*** The Deputy Assistant Secretary, Office of the Assistant Secretary (Financial Management and Comptroller) comments are responsive to the intent of the recommendation.

**3. Implement and follow procedures for obtaining and maintaining supporting documentation to comply with DoD Financial Management Regulation volume 1, chapter 3, “Accounting Systems Conformance, Evaluation, and Reporting,” May 1993.**

***Navy Comments.*** The Deputy Assistant Secretary, Office of the Assistant Secretary (Financial Management and Comptroller) concurred. The Deputy Assistant Secretary, Office of the Assistant Secretary (Financial Management and Comptroller) will publish clear guidance for Navy field activities. This guidance will address the Navy’s approach and expectations for maintaining supporting documentation for military equipment. The Navy will publish the guidance no later than September 30, 2009.

***Our Response.*** The Deputy Assistant Secretary, Office of the Assistant Secretary (Financial Management and Comptroller) comments are responsive to the intent of the recommendation.

**4. Establish documentation to support improvements, estimated useful life, and waivers.**

***Navy Comments.*** The Deputy Assistant Secretary, Office of the Assistant Secretary (Financial Management and Comptroller) concurred. The Deputy Assistant Secretary, Office of the Assistant Secretary (Financial Management and Comptroller) will publish clear guidance for Navy field activities. This guidance will establish appropriate documentation requirements for classifying assets as military equipment and granting of waivers. The Navy will publish the guidance no later than September 30, 2009.

***Our Response.*** The Deputy Assistant Secretary, Office of the Assistant Secretary (Financial Management and Comptroller) comments are responsive to the intent of the recommendation.

**5. Verify, in conjunction with the Defense Finance and Accounting Service, the reliability and accuracy of source records.**

***Navy Comments.*** The Deputy Assistant Secretary, Office of the Assistant Secretary (Financial Management and Comptroller) concurred. The Deputy Assistant Secretary, Office of the Assistant Secretary (Financial Management and Comptroller)

stated that the Navy currently has a Financial Improvement Plan to address deficiencies in reconciling the Fund Balance with Treasury that will enable the Navy to reconcile military equipment expenditures with disbursements.

***Our Response.*** The Deputy Assistant Secretary, Office of the Assistant Secretary (Financial Management and Comptroller) comments are responsive to the intent of the recommendation.

**6. Assist the Property and Equipment Policy Office in verifying the completeness of the military equipment program universe.**

***Navy Comments.*** The Deputy Assistant Secretary, Office of the Assistant Secretary (Financial Management and Comptroller) concurred. The Deputy Assistant Secretary, Office of the Assistant Secretary (Financial Management and Comptroller) will continue to work in cooperation with the Office of the Secretary of Defense P&EPO to verify the completeness of the military equipment universe.

***Our Response.*** The Deputy Assistant Secretary, Office of the Assistant Secretary (Financial Management and Comptroller) comments are responsive to the intent of the recommendation.

## **Appendix A. Scope and Methodology**

We conducted this financial-related audit from July 2007 through April 2008 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The P&EPO requested that the DoD Office of the Inspector General perform procedures to review the military equipment baseline as of September 30, 2006. Officials from both offices discussed and agreed upon objectives for the engagement. The agreed-upon objectives included evaluating the reliability of the internal controls over three of the financial statement assertions: valuation, rights and obligations, and completeness of the military equipment program universe. Specifically, we reviewed the reasonableness and reliability of the estimated historical acquisition costs that were developed using numerous sources including budget documents, financial reports, equipment inventory reports, and contract documentation. We tested controls in place as of September 30, 2006.

To test the financial statement assertions of valuation and rights and obligations, we statistically selected 45 military programs from the Navy military equipment baseline universe. See Appendix C for details. Because of the high error rate, we determined that completing the statistical sample would not provide additional benefit to the customer and we judgmental selected 35 programs from the statistical sample to test the valuation and rights and obligations assertions. To test the financial statement assertion of completeness, we examined all ship and aircrafts and selected 13 of all other assets from the Navy military equipment program universe. Our review did not address the existence or presentation and disclosure financial statement assertions.

### **Review of Internal Controls**

We determined that material internal control weaknesses in the Navy military equipment baseline existed as defined by DoD Instruction 5010.40, "Managers' Internal Control (MIC) Program Procedures," January 4, 2006. DoD Instruction 5010.40 states that internal controls are the organization, policies, and procedures that help program and financial managers to achieve results and safeguard the integrity of their programs. Implementing the recommendations will improve the Navy military equipment valuation. This report is one in a series, and the final report will contain recommendations to the P&EPO that should also correct the weaknesses identified in this report. We will provide a copy of this report to the senior officials responsible for internal controls for the Under Secretary of the Navy and P&EPO.

## **Use of Computer-Processed Data**

We relied on computer-processed data provided from P&EPO and its support contractor. We obtained the data from numerous DoD financial, acquisition, and logistics systems. We took information from the Capital Asset Management System—Military Equipment, Naval Air Command Enterprise Resource Planning System—Sigma, and the Standard Accounting and Reporting System. In addition, we extracted data from the Electronic Document Access, Naval Vessel Register, Aircraft Inventory Readiness and Reporting System, and the Cash History On-Line Operator Search Engine. Specifically, we used the computer-processed data to review program valuation calculations and examine supporting documentation adequacy. We did not determine the reliability of the computer-processed data. Not evaluating the controls did not affect the results of the audit objectives.

## **Use of Technical Assistance**

The DoD Office of Inspector General Quantitative Methods Directorate assisted with the audit. See Appendix C for detailed information about the work the Quantitative Methods Directorate performed.

## **Prior Coverage**

During the last 5 years, the Department of Defense Inspector General (DoD IG) and Air Force Audit Agency have issued five reports related to military equipment. Unrestricted DoD IG reports can be accessed at <http://www.dodig.mil/audit/reports>. Air Force Audit Agency reports can be accessed at <http://www.afaa.hq.af.mil>.

### **DoD IG**

DoD IG Report No. D-2008-126, “Report on Internal Controls Over the Army Military Equipment Baseline Valuation Effort,” August 29, 2008

DoD IG Report No. D-2008-074, “Memorandum Report on Internal Controls Over the Air Force Military Equipment Baseline Valuation Effort,” April 1, 2008

DoD IG Report No. D-2005-114, “Report on Development of DoD Baseline for Military Equipment,” September 30, 2005

DoD IG Report No. D-2005-112, “Report on the Review of the Development of the DoD Baseline for Military Equipment,” September 30, 2005

### **Air Force**

Air Force Audit Agency Report No. F2007-0009-FB3000, “Air Force Military Equipment Baseline Valuation,” May 29, 2007

# Appendix B. Valuation and Rights and Obligations Sample and Results

## Figure A. Sample

Program Name	Acquisition Value	Net Book Value
F/A - 18 Hornet E/F Models	\$21,597,063,568	\$17,845,367,934
F/A - 18 Hornet C/D Models	20,707,136,276	4,528,136,561
Trident II	12,709,752,000	6,985,518,240
T-45 Goshawk	4,537,369,710	3,422,081,458
USS <i>Ronald Reagan</i> (CVN 76)	4,530,402,881	4,077,782,559
USS <i>Abraham Lincoln</i> (CVN 72)	2,926,834,084	1,547,040,872
USS <i>Connecticut</i> (SSN 22)	2,390,034,053	1,804,290,211
P-3 Series - Modifications	2,362,095,631	1,414,195,842
USS <i>Jimmy Carter</i> (SSN 23)	2,144,663,725	2,044,372,000
USS <i>Dwight D. Eisenhower</i> (CVN 69) - Refueling Complex Overhaul	1,916,268,935	1,205,868,418
AN/SQQ-89 Surf ASW Combat System	1,537,998,535	281,554,852
SSN Acoustics	1,443,773,519	683,820,014
CH-46E - Naval Aviation Depot - Modifications	1,326,011,752	452,225,484
USS <i>Nebraska</i> (SSBN 739)	1,314,968,132	892,299,804
USS <i>Carl Vinson</i> (CVN 70) - Refueling Complex Overhaul	1,302,180,136	1,215,779,926
AEGIS Support Equipment	1,136,558,388	653,975,939
USS <i>Nevada</i> (SSBN 733)	1,057,857,896	541,522,489
USS <i>Kitty Hawk</i> (CVN 63) - Service Life Extension Program	954,686,046	31,840
USS <i>Bulkeley</i> (DDG 84)	914,316,546	770,618,340
USS <i>Essex</i> (LHD 2)	885,490,287	564,500,058
Strategic Platform Support Equipment CSS	879,943,954	253,293,392
USS <i>Chancellorsville</i> (CG 62)	817,264,906	135,290,475
Aviation Training Systems - Simulators for Navy/Marine Corp	805,335,718	240,906,457
USS <i>Paul Hamilton</i> (DDG 60)	793,376,567	532,890,586
USS <i>Dwight D. Eisenhower</i> (CVN 69)	755,392,710	118,704,567
USS <i>Fitzgerald</i> (DDG 62)	742,092,792	498,455,818
H-60 Helicopter Modifications	644,283,141	121,226,438
Common Avionics	519,267,475	311,572,312
Other Navigation Equipment	426,325,077	337,727,942
Aircraft Launch and Recovery Equipment	371,322,462	219,034,525
<i>Salt Lake City</i> (SSN 716)	318,014,876	101,186,552
Aircraft Rearming Equipment	299,058,799	116,103,994
Sonar Switches and Transducers	239,576,431	100,926,453
USS <i>Underwood</i> (FFG 36)	230,557,138	-
Automatic Carrier Landing System	80,487,877	65,463,983
<b>Total</b>	<b>\$95,617,762,023</b>	<b>\$54,083,766,335</b>



## Figure B. Valuation Testing Results - Improper Classification

Program Name	Acquisition Value	Net Book Value Misstatement (Over)Understated
AEGIS Support Equipment	\$1,136,558,388	\$ (653,975,939)
H-60 Helicopter Modifications	644,283,141	(121,226,438)
Common Avionics	519,267,475	(311,572,312)
<i>Salt Lake City</i> (SSN 716)	318,014,876	(101,186,552)
Sonar Switches and Tranducers	239,576,431	(100,926,453)
<b>Total</b>	<b>\$2,857,700,311</b>	<b>\$(1,288,887,694)</b>

## Figure C. Valuation Testing Results – Unable to Determine Proper Classification

Program Name	Acquisition Value	Net Book Value Potential Misstatement (Over)Understated
P-3 Series - Modifications	\$ 2,362,095,631	\$(1,414,195,842)
USS <i>Dwight D. Eisenhower</i> (CVN 69) - Refueling Complex Overhaul	1,916,268,935	(1,205,868,418)
AN/SQQ-89 Surf ASW Combat System	1,537,998,535	(281,554,852)
SSN Acoustics	1,443,773,519	(683,820,014)
USS <i>Carl Vinson</i> (CVN 70) - Refueling Complex Overhaul	1,302,180,136	(1,215,779,926)
Strategic Platform Support Equipment CSS	879,943,954	(253,293,392)
Other Navigation Equipment	426,325,077	(337,727,942)
Aircraft Launch and Recovery Equipment	371,322,462	(219,034,525)
Aircraft Rearming Equipment	299,058,799	(116,103,994)
Automatic Carrier Landing System	80,487,877	(65,463,983)
<b>Total</b>	<b>\$10,619,454,925</b>	<b>\$(5,792,842,888)</b>

## Figure D. Valuation Testing Results - Incorrect Estimated Useful Life<sup>4</sup>

Program Name	Acquisition Value	Net Book Value (Over)Understated
USS <i>Ronald Reagan</i> (CVN 76)	\$ 4,530,402,881	\$135,492,120
USS <i>Abraham Lincoln</i> (CVN 72)	2,926,834,084	413,937,964
USS <i>Connecticut</i> (SSN 22)	2,390,034,053	(11,764,671)
USS <i>Jimmy Carter</i> (SSN23)	2,144,663,725	(6,941,461)
USS <i>Dwight D. Eisenhower</i> (CVN 69) - Refueling Complex Overhaul	1,916,268,935	175,942,460
USS <i>Carl Vinson</i> (CVN 70) - Refueling Complex Overhaul	1,302,180,136	-
USS <i>Dwight D. Eisenhower</i> (CVN 69)	755,392,710	191,006,444
<i>Salt Lake City</i> (SSN 716)	318,014,876	-
USS <i>Underwood</i> (FFG 36)	230,557,138	49,954,046
<b>Total</b>	<b>\$16,514,348,538</b>	<b>\$947,626,902</b>

## Figure E. Valuation Testing Results - Unsupported Estimated Useful Life

Program Name	Acquisition Value	Net Book Value
P-3 Series - Modifications	\$2,362,095,631	\$1,414,195,842
AN/SQQ-89 Surf ASW Combat System	1,537,998,535	281,554,852
Strategic Platform Support Equipment CSS	879,943,954	253,293,392
Aircraft Launch and Recovery Equipment	371,322,462	219,034,525
Aircraft Rearming Equipment	299,058,799	116,103,994
Automatic Carrier Landing System	80,487,877	65,463,983
<b>Total</b>	<b>\$5,530,907,258</b>	<b>\$2,349,646,588</b>

<sup>4</sup> Programs with a dash represent misstatements that were calculated in other results to avoid duplication.

## Figure F. Valuation Testing Results – Acquisition Values<sup>5</sup>

Program Name	Acquisition Value	Acquisition Value Misstatement (Over)Understated
F/A - 18 Hornet E/F Models	\$21,597,063,568	\$ 337,004,243
F/A - 18 Hornet C/D Models	20,707,136,276	8,005,837
USS <i>Ronald Reagan</i> (CVN 76)	4,530,402,881	92,089,274
P-3 Series - Modifications	2,362,095,631	2,214,906
USS <i>Jimmy Carter</i> (SSN 23)	2,144,663,725	417,867,361
USS <i>Dwight D. Eisenhower</i> (CVN 69) -	1,916,268,935	682,408,737
CH-46E - Naval Aviation Depot -	1,326,011,752	-
USS <i>Nebraska</i> (SSBN 739)	1,314,968,132	6,593
USS <i>Bulkeley</i> (DDG 84)	914,316,546	96,098,591
Aircraft Rearming Equipment	299,058,799	114,794,031
Automatic Carrier Landing System	80,487,877	41,109,121
<b>Total</b>	<b>\$57,192,474,122</b>	<b>\$1,791,598,694</b>

## Figure G. Rights and Obligations Testing Results - Classification

Program Name	Acquisition Value	Net Book Value Misstatement (Over)Understated
CH-46E - Naval Aviation Depot - Modifications	\$ 1,326,011,752	\$ (452,225,484)
Marine Aircraft - Not sampled for Valuation and Rights and Obligations	25,500,492,750	(12,380,699,708)
<b>Total</b>	<b>\$26,826,504,502</b>	<b>\$(12,832,925,192)</b>

<sup>5</sup> Programs with a dash represent misstatements that were calculated in other results to avoid duplication.

## Figure H. Rights and Obligations Testing Results - Placed-in-Service

Program Name	Acquisition Value	Net Book Value Misstatement (Over)Understated
Trident II	\$12,709,752,000	\$ 89,452,800
USS <i>Dwight D. Eisenhower</i> (CVN 69) - Refueling Complex Overhaul	1,916,268,935	403,803,354
USS <i>Carl Vinson</i> (CVN 70) - Refueling Complex Overhaul	1,302,180,136	(1,215,779,926)
USS <i>Kitty Hawk</i> (CVN 63) - Service Life Extension Program	954,686,046	(31,840)
<b>Total</b>	<b>\$16,882,887,117</b>	<b>\$ (722,555,612)</b>

## Figure I. Completeness Testing Results - Ships

Program Name	Acquisition Value	Net Book Value Misstatement (Over)Understated
USNS <i>Mercy</i> (AH 19)	\$ 237,690,063	\$ (37,351,295)
USNS <i>Comfort</i> (AH 20)	213,015,563	(33,473,872)
<i>Thomas G. Thompson</i> (AGOR 23)	34,384,082	(8,555,088)
<i>Shrike</i> (MHC 62)	132,992,460	(94,226,026)
<i>Roger Revelle</i> (AGOR 24)	49,719,700	(24,418,788)
<i>Raven</i> (MHC 61)	141,668,701	(94,760,455)
<i>Cormorant</i> (MHC 57)	109,982,955	(69,212,599)
<i>Cardinal</i> (MHC 60)	123,146,872	(77,496,401)
<i>Black Hawk</i> (MHC 58)	133,975,385	(79,020,512)
<i>Atlantis</i> (AGOR 25)	55,455,283	(32,679,007)
<b>Total</b>	<b>\$1,232,031,064</b>	<b>\$(551,194,043)</b>

## Figure J. Completeness Testing Results – Aircraft

Program Name	Number of Aircraft	Acquisition Value	Net Book Value Misstatement (Over)Understated
P-3 Series	69	\$1,417,716,849	\$ (441,818,096)
MV-22 Osprey	13	1,389,665,979	(1,139,855,444)
AV-8B	18	401,388,822	(112,388,910)
MH-60R Seahawk	3	183,960,216	(178,840,822)
F/A-18 E/F	2	165,877,150	(88,921,359)
CH-53E/MH-53E	6	113,484,058	(41,521,598)
T-45 Goshawk	4	101,172,655	(73,289,442)
MH-60S Seahawk	4	94,357,859	(87,884,315)
F/A-18 C/D	2	64,697,800	(3,611,369)
E-2C	1	51,783,817	(8,927,224)
AV-8B Remanufacture	1	50,018,807	(30,263,539)
C-2AR	1	31,568,327	(3,954,092)
AH-1W	3	21,644,160	(7,396,970)
T-34	17	10,772,985	(1,725,184)
UC-35	1	7,428,818	(7,280,242)
TH-57	8	6,589,344	(3,179,124)
T-6A Texan II	1	4,698,759	(4,248,790)
T-2C	4	3,785,220	-
F-5 Adversary	6	3,224,220	(3,143,610)
H-53 Mods	2	3,174,299	(1,942,917)
C-12	1	2,394,458	(171,942)
<b>Total</b>	<b>167</b>	<b>\$4,129,404,602</b>	<b>\$(2,240,364,989)</b>

## Figure K. Calculation of Net Misstatement

	Net Book Value Misstatement (Over)Understated	Acquisition Value Misstatement (Over)Understated
<b>Valuation Testing</b> (See Appendix B - Figures B thru F.)		
Improper Classification	\$ (1,288,887,694)	
Incorrect Estimated Useful Life	947,626,902	
Acquisition Values		\$1,791,598,694
<b>Rights and Obligations Testing</b> (See Appendix B - Figures G and H.)		
Improper Classification	(12,832,925,192)	
Incorrect Placed-in-Service Date	(722,555,612)	
<b>Completeness Testing</b> (See Appendix B - Figures I and J.)		
Improperly Included Ships	(551,194,043)	
Improperly Included Aircraft	(2,240,364,989)	
<b>Total</b>	<b>\$(16,688,300,628)</b>	<b>\$1,791,598,694</b>



# Appendix C. Statistical Sampling Methodology

## Quantitative Plan

**Objective:** To determine whether acquisition valuations were correct and if control procedures were correctly followed.

**Population:** The population consisted of an Excel file containing 448 programs valued at \$304,213,866,570 and contained 36,058 end item transactions. The programs were categorized by average cost and group composite method. There were 370 programs using an average cost method that amounted to \$284,104,312,827 that contain 35,262 end item transactions. There were 78 programs using a group composite method that amounted to \$20,109,553,743 that contained 796 end items.

**Measures:** The variable measure was the dollar difference between the stated item value and the audited value. The attribute measure of correct or incorrect was used to determine if the item audited met the required conditions.

**Parameters:** We used a 90 percent confidence level for the statistical estimate.

## Sample Plan

We used a two-stage sample design. Stage 1 was a probability proportional to size (pps) design by acquisition value. Stage 2 was a simple random sample of program end items. Programs were sampled separately based on the costing method, average cost, and group composite.

Stage 1 average cost. We selected 40 programs (28 unique programs) using pps with replacement.

Stage 1 group composite. We selected 20 programs (17 unique programs) using pps with replacement.

Stage 2 average cost. We selected 20 end items from each of the 40 average cost programs without replacement. Total sample size was 458.

Stage 2 group composite. We selected 20 end items from each of the 20 group composite programs without replacement. If there were fewer than 20 end items in a program, 100 percent of the items were selected. Total sample size was 267. We used the random number generator in SAS version 9.1 to select the random samples.

## Statistical Analysis and Interpretation

Quantitative Methods Directorate did not make any statistical projections. Because of the high error rate, the statistical sample was not completed.





# Department of the Navy Comments



**DEPARTMENT OF THE NAVY**  
OFFICE OF THE ASSISTANT SECRETARY  
(FINANCIAL MANAGEMENT AND COMPTROLLER)  
1000 NAVY PENTAGON  
WASHINGTON DC 20350-1000

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MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDITING,  
DEPARTMENT OF DEFENSE

Subj: DODIG REPORT NUMBER D-2007-D000FN-0214.000,  
"INTERNAL CONTROLS OVER THE DEPARTMENT OF THE NAVY  
MILITARY EQUIPMENT BASELINE VALUTION EFFORT"  
DATED JULY 3, 2008

Ref: (a) Department of Defense Inspector General (DoDIG)  
Draft Report number D-2007-D000FN-0214.000

Encl: (1) Office of the Assistant Secretary of the Navy  
(Financial Management Office), (OASN(FM&C) (FMO)  
response to Draft DoDIG Audit Report dated July 3,  
2008

We have reviewed the subject DODIG draft report  
forwarded by reference (a).

In coordination with the Deputy Assistant Secretary of  
the Navy for Research, Development and Acquisition,  
DASN(RD&A), we include our response and it is provided at  
enclosure (1).

My point of contact for this draft audit is Mr. Kyle  
Fugate at (202)685-6718, [kyle.fugate@navy.mil](mailto:kyle.fugate@navy.mil)

A handwritten signature in black ink, appearing to read "Mark E. Easton", is written over the typed name.

MARK E. EASTON  
Deputy Assistant Secretary  
(Financial Operations)

**DEPARTMENT OF THE NAVY  
RESPONSE TO DODIG DRAFT AUDIT REPORT  
ON "INTERNAL CONTROLS OVER THE DEPARTMENT OF THE NAVY  
MILITARY EQUIPMENT BASELINE VALUTION EFFORT"  
(Project No. D-2007-D000FN-0214.000)**

The following is provided in response to the recommendations identified in draft audit report # D-2007-D000FN-0214.000

**Recommendation 1:** Implement and follow procedures for classifying assets as military equipment, establishing assets useful life, and determining assets' placed in service date to comply with DoD Financial Management Regulation volume 4, chapter 6, "Property, Plant, and Equipment," July 2006.

**DON Response to Draft Report:** Department of the Navy (DON) concurs. DON will promulgate clear guidance for Navy field activities that consolidates applicable existing DoD regulations into Navy specific guidance. This guidance will address Navy's approach and expectations as they relate to procedures for classification and determination of placed-in-service dates and useful life for military equipment. This guidance will be published no later than September 30, 2009. DON will also execute future surveys of field activities to ensure that the guidance is effectively implemented.

**Recommendation 2:** Implement and follow procedures for classifying assets as military equipment and establishing assets' useful life to comply with the Statement for Federal Accounting Standards No. 6, "Accounting for Property, Plant, and Equipment," June 1996 as amended.

**DON Response to Draft Report:** Department of the Navy (DON) concurs. DON will promulgate clear guidance and develop and test internal controls for Navy activities to ensure that classification and determination of placed-in-service dates and useful life for military equipment will reflect the requirements of Statement for Federal Accounting Standards No. 6. This guidance and controls will be in place no later than September 30, 2009.

Encl 1

**Recommendation 3:** Implement and follow procedures for obtaining and maintaining supporting documentation to comply with DoD Financial Management Regulation volume 1, chapter 3, "Accounting Systems Conformance, Evaluation and Reporting," May 1993.

**DON Response to Draft Report:** Department of the Navy (DON) concurs. DON will promulgate clear guidance for Navy field activities that consolidates applicable existing DoD regulations into Navy specific guidance. This guidance will address Navy's approach and expectations as they relate to procedures for maintaining supporting documentation for military equipment. This guidance will be published no later than September 30, 2009. DON will also execute future surveys of field activities to ensure that the guidance is effectively implemented.

**Recommendation 4:** Establish documentation to support improvements, estimated useful life, and waivers.

DON Response to Draft Report: Department of the Navy (DON) concurs. DON will promulgate clear guidance for Navy field activities that establishes appropriate documentation requirements to support classification of military equipment based on its status as an improvement to existing equipment, its estimated useful life, and waivers to established guidance. This guidance will be published no later than September 30, 2009. DON will also execute future surveys of field activities to ensure that the guidance is effectively implemented.

**Recommendation 5:** Verify in conjunction with the Defense Finance and Accounting Service, the reliability and accuracy of source records.

**DON Response to Draft Report:** Department of the Navy (DON) concurs. DON currently has a FIP effort in process to address deficiencies in reconciling Fund Balance With Treasury that will enable the Navy to reconcile military equipment expenditures with disbursements.

**Recommendation 6:** Assist the Property and Equipment Policy Office in verifying the completeness of the military equipment program universe.

Encl 1

DON Response to Draft Report: Department of the Navy (DON) concurs. DON will continue to work in cooperation with OSD P&EPO to verify the completeness of the military equipment universe.

Encl 1

# Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics Comments



ACQUISITION,  
TECHNOLOGY  
AND LOGISTICS

OFFICE OF THE UNDER SECRETARY OF DEFENSE  
3000 DEFENSE PENTAGON  
WASHINGTON, DC 20301-3000

JUL 31 2008

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL AND DIRECTOR,  
DEFENSE FINANCIAL AUDITING SERVICE, DoDIG

SUBJECT: Department of Defense Office of Inspector General Draft Report, *Internal Controls Over the Navy Military Equipment Baseline Valuation Effort*,  
Project No. D2007-D000FN-0214.000

Thank you for the opportunity to meet with your audit team and review their findings.

My staff will continue to work with the Navy on issues related to documentation identified in your report. However, there are some other issues highlighted in the attached comments that we believe should be revised so that the final report provides a more accurate representation of your findings.

If you have any questions regarding these comments, please contact Mr. Harry Chelpon. He may be reached at 703-604-6350 x101 or at [Harry.Chelpon@osd.mil](mailto:Harry.Chelpon@osd.mil).

Nancy L. Spruill  
Director, Acquisition Resources  
and Analysis

Attachment:  
As stated

cc:  
DCFO  
DASN (M&B)  
Director, FMO



## COMMENTS:

1. **Valuation: Classification** - The draft report states that the Navy and the Property and Equipment Policy Office (P&EPO) misclassified five programs, valued at approximately \$2.9 billion Acquisition Value (AV), as military equipment. Four of these programs had been valued using the Group and Composite (G&C) methodology, which requires the capitalization of all items included in a Group as long as a single item exceeds the capitalization threshold of \$100,000. The final report should clarify, by program, whether the DoDIG believes that the programs should be reported as General Property, Plant and Equipment (GPP&E) instead of military equipment (ME), should be expensed as maintenance rather than modifications, or should be expensed as being below the capitalization threshold. The final report should also indicate whether the DoDIG supports capitalization using the Group and Composite methodology described above. The fifth program, the SSN 716 Salt Lake City, should have been reported as retired for financial statement purposes and it was not. This error has been corrected.

The draft report also states that the DoDIG team was unable to determine if management properly classified improvements (modifications) for 10 programs, valued at \$10.6 billion AV / \$5.8 billion Net Book Value. The final report should recognize that this issue relates primarily to differing interpretations of the requirement of the accounting standards and that modifications, and a number of other issues related to the capitalization of GPP&E, are currently being reviewed by the Accounting and Auditing Policy Committee (AAPC). The AAPC is developing implementation guidance to clarify requirements related to issues such as the difference between asset maintenance and asset modification.

2. **Valuation: Estimated Useful Life** - The final report should recognize that the useful lives included in the valuations were provided by and attested to by the responsible program managers.
3. **Valuation: Acquisition Values** - The final report should recognize that the valuations were based on the expenditure data included in the Navy accounting system and that the variance identified in the draft report relates to differences in Navy information systems.
4. **Rights and Obligations: Classification** - The draft report indicates that a number of assets were misclassified as ME and that the DoDIG relied on information included in the Naval Vessel Register and the Aircraft Inventory and Readiness Reporting System to make these determinations. The report also indicates that aircraft being flown by Marine Corps pilots should be reported as Marine Corps, not Navy, assets based on the "Preponderance of Use" policy. This is a known issue that is currently being addressed by the P&EPO, Navy, and Marine Corps.

Since the accounting standards do not define military equipment, the criteria used to categorize assets as ME should be based on the definition developed by the Department, not by the system used to track the assets. The final report should recognize that classification issues relate to compliance with policy rather than accounting standards. It should also be

recognized that all of these assets will be reflected as General Property, Plant and Equipment in the Department of the Navy and Department of Defense financial statements.

5. **Rights and Obligations: Placed in Service** – The final report should recognize that the placed-in-service dates included in the valuations were provided by and attested to by the responsible program managers.
6. **Completeness: Number of Assets** - The final report should clarify whether the issue is limited to classification, i.e., all the identified assets were reflected in the Navy financial statements as either GPP&E or ME, or whether the Navy had failed to report a number of the assets as either GPP&E or ME.
7. **Completeness: Waivers** – The final report should recognize that the waiver determinations included in the valuations were provided by and attested to by the responsible program managers.



## **Team Members**

The Department of Defense Office of the Deputy Inspector General for Auditing, Defense Business Operations prepared this report. Personnel of the Department of Defense Office of Inspector General who contributed to the report are listed below.

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# Inspector General Department of Defense